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4-1

REPORT BY THE U.S.

General Accounting Office

Features Of Nonfederal Retirement Programs

This report depicts the prevailing features of nonfederal retirement programs as shown by selected studies and/or data bases. Pension plans and capital accumulation plans are analyzed to assist the Congress in its efforts to design new retirement programs for federal employees covered by social security.

GAO/OCG-84-2
JUNE 26, 1984

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COMPTROLLER GENERAL OF THE UNITED STATES
WASHINGTON D.C. 20548

B-214421

The Honorable William V. Roth, Jr.
Chairman, Committee on Governmental Affairs
United States Senate

The Honorable Ted Stevens
Chairman, Subcommittee on Post Office, Civil
Service, and General Services
Committee on Governmental Affairs
United States Senate

The Honorable Thomas F. Eagleton
Ranking Minority Member
Committee on Governmental Affairs
United States Senate

The Honorable Jeff Bingaman
Ranking Minority Member
Subcommittee on Post Office, Civil Service,
and General Services
Committee on Governmental Affairs
United States Senate

Subject: Features of Nonfederal Retirement Programs
(GAO/OCG-84-2)

This report, prepared in response to your joint request of August 5, 1983, analyzes the features of nonfederal retirement programs. As requested, it provides information on public and private sector pension plans as well as related information on capital accumulation plans. A subsequent report will address the levels of benefits employees receive from the nonfederal programs.

In preparing this report, we relied on data developed by other organizations rather than independently collecting new information. In general, these sources focused on retirement programs for salaried employees. Although they were not purported to be statistically representative of all nonfederal sector retirement programs, we found the sources to be sufficiently consistent in their findings that the prevailing features of the retirement programs covered could be readily identified.

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As arranged with your offices, unless you publicly announce its contents earlier, we plan no further distribution of this report for 30 days. At that time, we will send copies to interested parties and make copies available to others upon request.

Clifford I. Gould
Assistant to the Comptroller
General for Federal
Retirement Matters

Enclosure

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REPORT BY THE UNITED STATES
GENERAL ACCOUNTING OFFICE

FEATURES OF NONFEDERAL RETIREMENT PROGRAMS

D I G E S T

The Congress set December 31, 1985, as the target date for the establishment of new retirement programs for federal civilian employees hired after December 31, 1983. Unlike earlier hires, these employees are covered by social security. If the new programs are not in place by the target date, most new employees will be covered by and contribute fully to both social security and the existing civil service retirement system--a situation that would be very expensive for the employees and the government.

To assist in the design of a new civil service retirement system, the Senate Committee on Governmental Affairs and its Civil Service, Post Office, and General Services Subcommittee asked the General Accounting Office (GAO) to obtain information on retirement programs in the nonfederal sector.

This report concentrates on the features of nonfederal sector retirement programs. A subsequent report will address the levels of benefits employees receive from the nonfederal programs.

GAO used selected surveys and data bases rather than independently collecting new information. The primary sources used were the Bureau of Labor Statistics, the Bankers Trust Company, Hay Associates, the Wyatt Company, Hewitt Associates, and the National Association of State Retirement Administrators. Overall, the surveys focused on retirement programs for salaried employees. (See pp. 1 to 3.)

Retirement programs available in the nonfederal organizations surveyed typically consisted of three parts:

--social security,

--a pension plan, and

--capital accumulation plans.

Since social security will be common to both the newly designed federal programs and the nonfederal sector's programs, GAO's analysis concentrated on the pension and capital accumulation portions of nonfederal programs.

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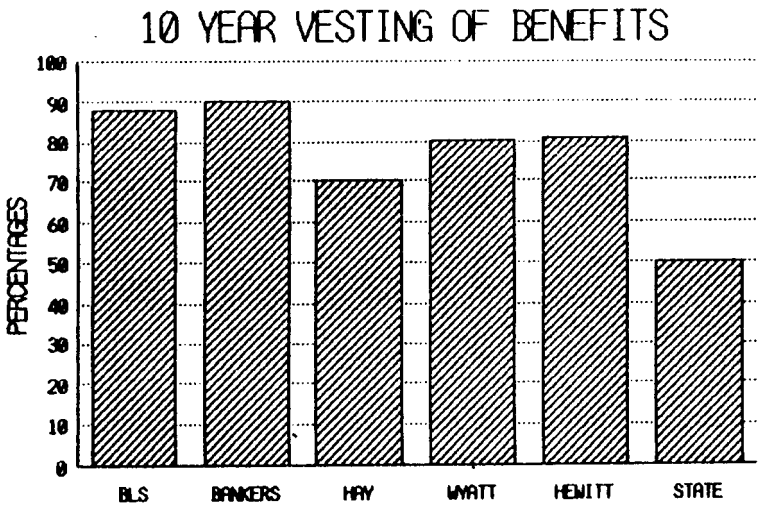
PENSION PLANS

The following sections highlight the prevailing features in the nonfederal pension plans surveyed. Where charts are used, they depict the percentages of the plans or covered employment in which the surveys found the features to exist. (The Bureau of Labor Statistics expressed its findings as percentages of surveyed employees who were covered by the various pension plan features. The other surveys used the number of plans studied as the analytical element.)

Vesting

Vesting, in pension terminology, means that point in time at which a plan participant has earned the right to a retirement benefit regardless of whether he/she continues to be employed under the plan. In the nonfederal sector, vesting usually occurs at 10 years of service. (See pp. 4 and 5.)



Integration with social security

The prevailing private sector practice is to coordinate or integrate the pension plan with social security. In contrast, most states add pension plan benefits to social security with no integration.

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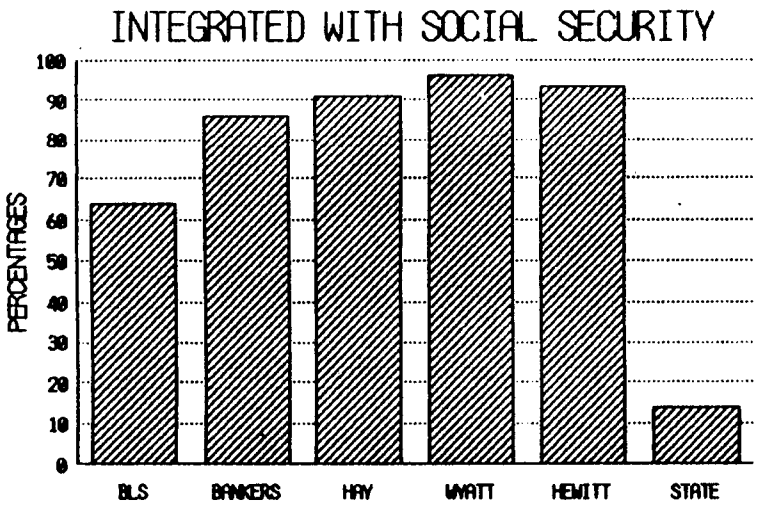
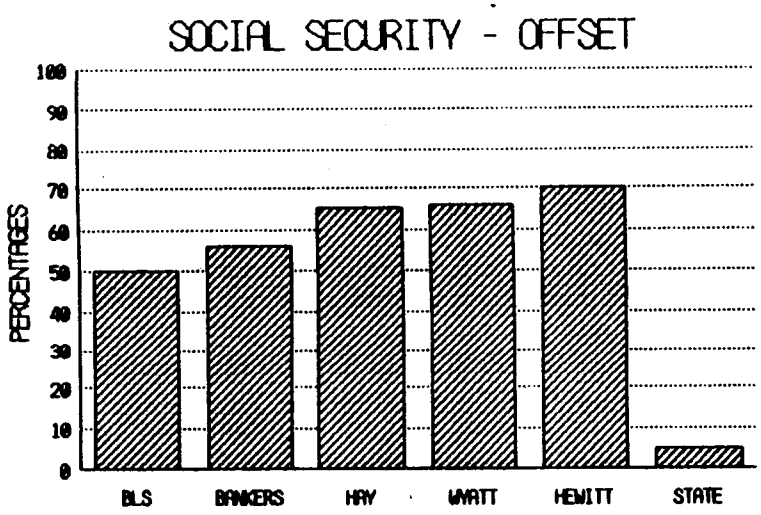


The method most often used when pension plans are integrated with social security is to offset the amounts the plans would otherwise pay by some portion of social security benefits. (See pp. 5 and 6.)



Pension plan benefits

Some nonfederal sector pension plans provide the same benefit amounts for each year of service to all employees—regardless of salary level. However, the Bureau of Labor Statistics data showed the majority of employees surveyed are in plans that apply benefit formulas to the average salary earned in the employee's final years of employment to calculate benefit amounts. Most private sector plans surveyed use a 5-year average salary. Some private sector plans and a slight majority (52 percent) of state plans use a 3-year average salary. (See pp. 6 and 7.)

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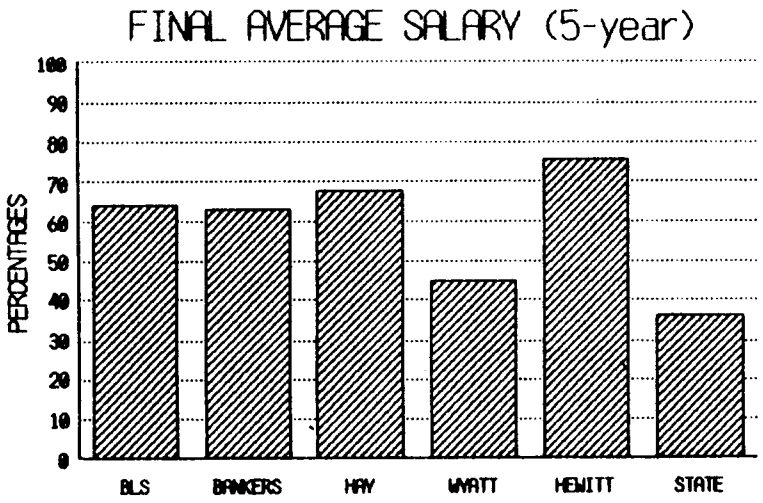
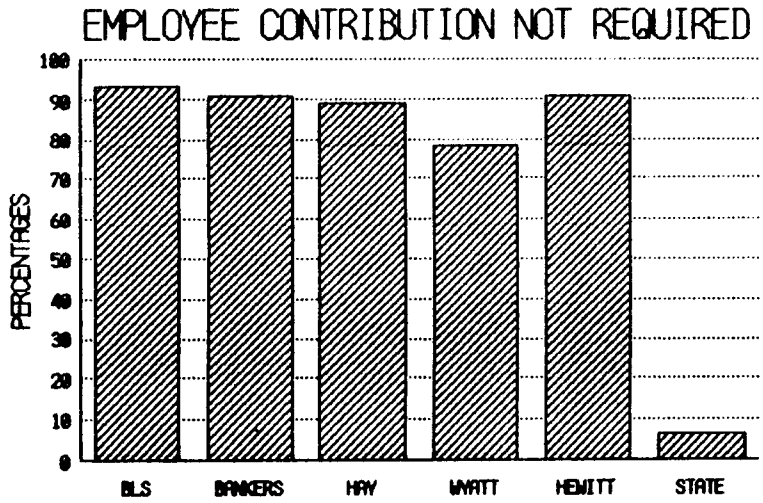


Employee contributions

Very few private sector pension plans require employee contributions. By contrast, state plans generally require employee contributions. (See pp. 7 and 8.)



Retirement age

Overall, the studies showed that the earliest age at which employees in the majority of private sector plans could receive unreduced pension benefits was age 62 or younger. In state plans, unreduced benefits were typically payable by age 60. (See pp. 10 and 11.)

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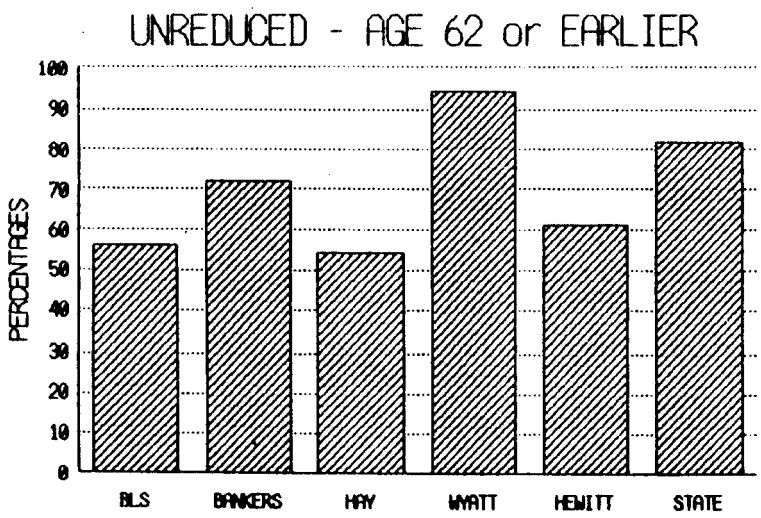
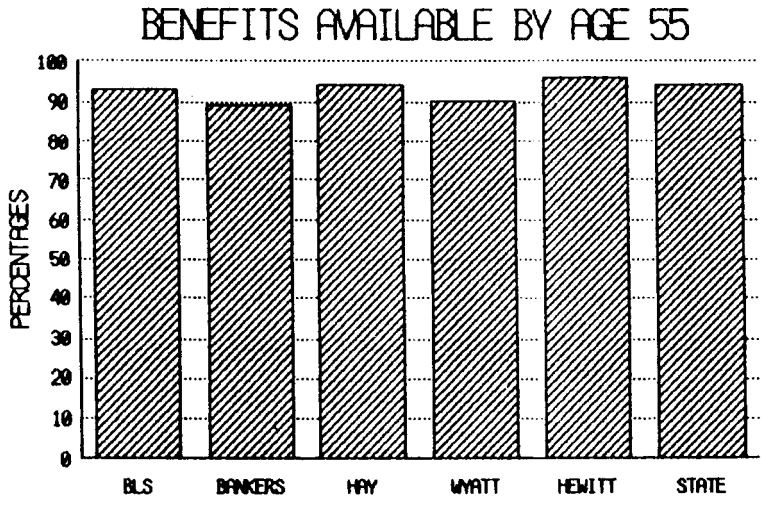


Nonfederal pension plans also permit employees to retire before they attain the requirements necessary for the payment of unreduced benefits. When employees retire early, benefit amounts are reduced. Early retirement is typically available by age 55 in both private sector and state plans. (See pp. 11 and 12.)



Post-retirement adjustments

In addition to the full inflation indexing of retirees' social security benefits, nonfederal employers also provided increases to retirees' pensions. (See p. 20.)

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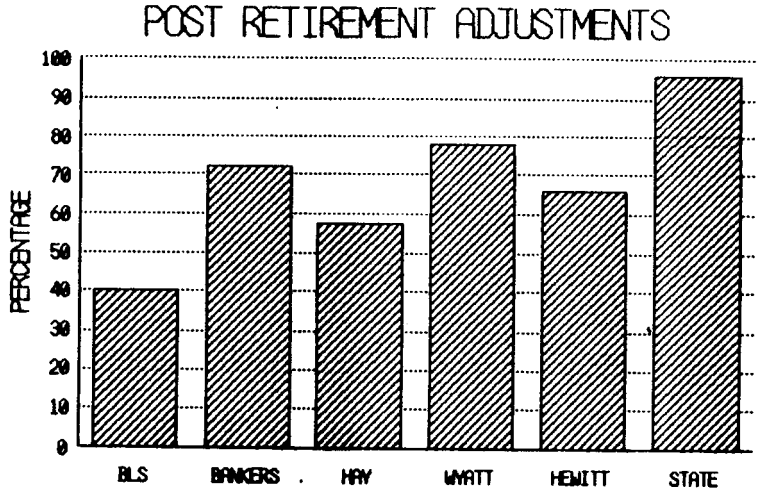

These data on pension adjustments were supported in a separate analysis sponsored by the Department of Labor. The study examined pension payments during 1973 to 1979 to a sample of all private sector retirees who were retired in 1972. It found that 75 percent of the retirees had received adjustments to their pension benefits during that time period. According to the study, benefits for all retirees, as a group, increased by amounts equivalent to about 38 percent of the increase in the Consumer Price Index during the period, ranging from about 6 percent for retirees in the smallest plans to 57 percent for retirees in the largest plans. (See pp. 20 and 21.)

Other provisions

In addition to employee pensions, nonfederal sector pension plans may also provide disability and survivor benefits. The provisions shown by the studies for these benefits were as follows:

--Private sector disability benefits may come from the pension plan, a long-term disability insurance plan, or both in addition to social security disability benefits. (See pp. 13 and 14.)

--Long-term disability insurance was the approach most often used by private sector employers with salary-based pension plans. Disabled employees under these plans generally receive benefits of 60 percent or more of pay until they reach retirement age, when deferred pension benefits begin. (See pp. 16 and 17.)

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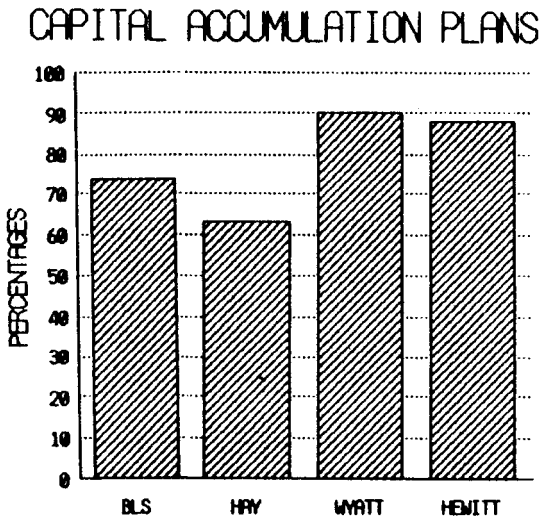
--Only five states used long-term disability insurance. The others provided for disability benefits under the pension plans. (See p. 13.)

--Most private sector pension plans require employees to be eligible for early retirement before survivor benefits are payable upon their death. There was no similar prevailing practice in state pension plans--survivorship eligibility requirements ranged from immediate coverage to eligibility for early retirement. (See pp. 18 and 19.)

--In virtually all the private sector pension plans, retirement benefits were reduced when employees elected survivor benefit coverage. Most private sector plans imposed an actuarial reduction, whereby the reduction in pension benefits was sufficient to cover the anticipated survivor benefit amount. (See pp. 19 and 20.)

CAPITAL ACCUMULATION PLANS

The studies showed that most private sector employers surveyed provide capital accumulation plans as part of the retirement income program. Capital accumulation plans include programs such as employee stock-ownership plans, profit-sharing plans, thrift plans, and deferred compensation plans. (See pp. 22 and 23.)



Of the various types of capital accumulation plans provided in the private sector, the studies showed thrift plans to be the most prevalent. With thrift plans, employers help employees save for retirement and other needs by matching some portion of the employees' contributions to the plan. According to the studies, thrift plans had the following common characteristics:

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--Most employers matched at least 50 percent of employees' contributions up to a specified level. (See pp. 23 and 24.)

--Employee contributions of at least 6 percent of pay were subject to employer matching in most plans. (See p. 24.)

--The plans usually required employees to have 1 year of service to be eligible to participate. (See p. 25.)

--Employees had vested rights to employer contributions in 5 years or less. (See pp. 25 and 26.)

GAO found that tax-sheltered deferred compensation plans authorized by section 401(k) of the Internal Revenue Code are achieving popularity in the private sector. Such plans are similar to thrift plans, but, under the 401(k) approach, employee contributions are considered to be a salary reduction and are not subject to taxation until withdrawn from the plan. (The deferred taxation arrangement applies to employer contributions and earnings on plan investments in both thrift plans and 401(k) plans.) In many instances, companies amended or used existing thrift plans when establishing a 401(k) plan.

Limited information was available on capital accumulation plans in the nonfederal public sector. However, a November 1982 survey of 36 states showed that 33 of them had established or authorized deferred compensation plans for their employees in addition to their pension plans.

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ABBREVIATIONS

BLS	Bureau of Labor Statistics
CPI	Consumer Price Index
ERISA	Employee Retirement Income Security Act
GAO	General Accounting Office
LTD	long-term disability

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CHAPTER 1

INTRODUCTION

The Social Security Amendments of 1983 (Public Law 98-21), primarily intended to resolve financial difficulties in the social security system, had a significant effect on the retirement program for future federal employees. The amendments required that all federal civilian employees first hired after December 31, 1983; former employees returning to federal employment after a break in service of 1 year or more; and elected and politically appointed officials be covered by the social security program. Civilian employees of the government before January 1984 were generally not in social security. Most of them were covered by the civil service retirement system. Others were in retirement systems designed for particular groups of employees, such as the Foreign Service and the Federal Reserve Board retirement systems.

If social security coverage were merely added to the existing retirement systems, the result would be a very costly program with combined benefits at retirement exceeding the salary levels of many employees. Thus, new retirement programs to supplement social security coverage are needed.[1]

On August 5, 1983, the Chairmen and Ranking Minority Members of the Senate Committee on Governmental Affairs and its Civil Service, Post Office, and General Services Subcommittee requested our assistance in the design of a new civil service retirement system. We were asked to collect and analyze information on prevailing retirement features in the nonfederal sector (both public and private) for use by the committee in its assessment of pension policy alternatives. This report contains the results of our analyses.

OBJECTIVES, SCOPE, AND METHODOLOGY

In accomplishing our objectives, we relied on data contained in selected surveys and studies. The scope of the surveys ranged from very large firms to companies employing as few as 50 people. After reviewing (but not verifying) these sources, we concluded they were sufficiently consistent in their findings that prevailing retirement program features could be identified without independent data-gathering on our part. However, they are not presented as statistically representative of all nonfederal sector retirement programs.

As agreed with the committee, our primary source of information was a report by the Department of Labor's Bureau of Labor Statistics (BLS) entitled "Employee Benefits in Medium and Large Firms" and the data bases supporting the report. This report is prepared annually by BLS on the basis of its analysis of

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[1]The dual coverage problem was temporarily resolved by Public Law 98-168, dated November 29, 1983. This legislation provided that, until December 31, 1985, employees covered by both social security and an existing government employee retirement system will be required to contribute no more in total to the two programs than the contributions required of employees who are not in social security. If any such employee becomes eligible to receive benefits from both programs during the period, social security payments will be totally offset against payments from the retirement system.

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retirement and other benefit programs in the private sector establishments used in the federal pay comparability process for salaried employees. Therefore, it is not necessarily representative of the entire private sector. The 1982 report--the last one completed at the time of our review--covered a survey universe of about 21 million employees, of whom an estimated 84 percent, or 17 million employees, participated in pension plans. A total of 976 pension plans was included in the BLS survey. The BLS survey universe included establishments employing as few as 50, 100, or 250 full-time employees, depending on the industry surveyed.

Other studies we used to supplement and confirm the BLS data were as follows:

--The Bankers Trust Company, "Corporate Pension Plan Study--A Guide for the 1980s." This study included 325 retirement plans in 240 companies, of which the Bankers Trust Company characterized 216 as "large" and 24 as "small." Retirement plans in the 240 companies covered 8.2 million employees.

--Hay Associates, "1983 Hay-Huggins Noncash Compensation Comparison." This study included 781 private sector retirement plans. The study report did not indicate the number of employees covered by the plans, but Hay Associates representatives said that about one-third of the plans surveyed covered 1,000 or fewer employees.

--Hewitt Associates, "Salaried Employee Benefits Provided by Major U.S. Employers in 1982." This report covered 678 private sector retirement plans. The report identified the companies involved but gave no information on the number of employees in the plans.

--The Wyatt Company, "A Survey of Retirement, Thrift, and Profit-Sharing Plans Covering Salaried Employees of 50 Large U.S. Industrial Companies as of January 1, 1983." The report did not contain information on the number of employees in the plans.

--The National Association of State Retirement Plan Administrators, September 30, 1982, "Survey of State Retirement Systems." We used the survey data on general employees (about 2.5 million state employees and about 1.1 million local government employees who participate in the various state plans) and did not use the survey data on special categories of employees such as police, firefighters, and teachers.

Since all the studies did not identify their survey participants, we could not determine the extent to which duplication in participant coverage might exist. Moreover, each of the studies did not always include data on all the retirement program provisions discussed in this report. Where possible, we supplemented the available data with information contained in other, more limited studies. We also visited retirement plan administrators in 10 major corporations.

STRUCTURE OF NONFEDERAL RETIREMENT PROGRAMS

The studies discussed in this report focused primarily on retirement programs for salaried employees. Programs available to these employees in the

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nonfederal organizations surveyed typically consisted of three parts--social security, a pension plan, and capital accumulation plans.

There are two basic types of pension plans--defined contribution and defined benefit. A defined contribution plan specifies the rate at which funds will be added to each participant's account, and the benefits consist of the accumulated contributions and investment earnings or losses at the time of retirement. Defined benefit plans use specified formulas which consider such factors as salary, age, and years of service to compute benefit amounts. Contributions to defined benefit plans are based on the amounts necessary to fund the benefit payments produced by the formula.

The BLS data showed that 99 percent of the employees in the survey were in defined benefit pension plans and 1 percent in defined contribution pension plans. Only one of the states had a defined contribution pension plan. Five percent of the companies in the Hay Associates survey had defined contribution pension plans. The other studies included only defined benefit plans.

Defined benefit pension plans generally fall into two categories--compensation-based plans and dollar amount plans. Compensation-based plans consider both employees' pay and years of service in the computation of benefits and commonly cover salaried employees. Dollar amount plans provide a flat dollar benefit for each year of service to all covered employees regardless of pay level and commonly cover hourly paid employees. As shown below, 67 percent of the participants in the BLS survey were covered by compensation-based plans.

DEFINED BENEFIT PENSION PLANS FOR WORKERS IN BLS SURVEY

Occupational group	Total	Dollar amount formulas	Compensation-based formulas
	(percentage of participants)		
All workers	100	33	67
Professional and administrative	25	2	23
Technical and clerical	26	4	22
Production	49	27	22

Capital accumulation plans are generally supplements to basic pension plans. A wide variety of capital accumulation plans exist, including employee stock-ownership plans, profit-sharing plans, savings and investment plans, and deferred compensation plans. They are considered to be defined contribution plans under provisions of the Employee Retirement Income Security Act (ERISA).

Chapter 2 of this report discusses features of the defined benefit pension plans included in the studies. Chapter 3 discusses features of the capital accumulation plans studied.

Social security is a basic part of all private sector retirement programs. Similarly, employees in 43 states are covered by social security. Thus, social security benefits, as such, are not analyzed in this report other than where necessary to describe how pension plans are designed to recognize the benefits available to employees from social security.

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CHAPTER 2

EMPLOYER PENSION PLANS

This chapter describes the provisions of nonfederal defined benefit pension plans as disclosed by the several studies we examined. As will be evident, very few pension plans are alike in all respects. Nevertheless, the predominant, or prevailing, features of the plans as a whole are readily apparent. Each of the studies did not cover all pension plan features. Where a study is omitted as a source, it did not cover the feature being discussed.

ELIGIBILITY FOR COVERAGE

ERISA requires that, if a private sector employer has a pension plan, it must cover all employees when they reach age 25 and have a minimum of 12 months of service. According to BLS, about 70 percent of the employees it surveyed were in plans with participation requirements more liberal than the ERISA requirement. About 39 percent of the BLS survey participants were in plans that granted pension plan coverage immediately upon employment. Another 31 percent were in plans that in some other manner provided coverage earlier than required by ERISA. As shown below, this BLS data agreed with the Bankers Trust Company and Hay Associates surveys:[2]

PENSION PLAN PARTICIPATION REQUIREMENTS

	BLS	Bankers Trust	Hay
	---(percentages)---		
Meet ERISA requirement	30	30	43
More liberal than ERISA	70	70	57

VESTING PROVISIONS

Vesting, in pension terminology, means the point at which a plan participant has earned the right to a retirement benefit regardless of whether he/she continues to be employed under the plan. The BLS survey and other studies indicate that most plans provide for "cliff" vesting, whereby a specified number of years of service must be completed before any benefits vest. In contrast, other plans provide for graduated vesting, whereby employees become entitled to an increasing portion of their accrued pension benefits over time. In the BLS survey, 88 percent of the employees were in plans with cliff vesting at 10 years of service. Similarly, the other studies showed that 70 percent to 90 percent of the private sector plans surveyed had cliff vesting at 10 years. Fifty percent

[2]The BLS statistics cited here and elsewhere in this chapter use pension plan participants as the analytical element. All the other sources use the number of pension plans studied as the analytical element.

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of state government plans had cliff vesting at 10 years. An additional 38 percent of state plans had cliff vesting at 5 years of service.

VESTING OF RETIREMENT BENEFITS

	BLS	Bankers Trust	Hewitt	Hay	Wyatt	State
	(percentages)					
Immediate	-	-	1	-	-	-
Cliff vesting						
5 years	-	-	1	-	-	38
10 years	88	90	81	70	80	50
Other	2	2	1	14	-	12
Graduated vesting						
15 years	4	8	12	8	-	-
Other	6	-	4	8	20	-

SOCIAL SECURITY INTEGRATION

A pension plan is integrated with social security to the extent it recognizes social security in establishing benefits. Because social security benefits as a percent of salary decrease as income levels increase, integrated plans attempt to compensate for this decrease.

Pension plans generally use one of two basic approaches--offset or step-rate--to facilitate integration of plan benefits with social security across various income levels. Under the offset approach, a portion of an employee's social security benefit is deducted from the benefits that would otherwise be payable under the plan's pension formula. Under the step-rate approach, the plan benefit formula used to compute an employee's annuity is comprised of two different percentage factors. One percentage factor is applied to that portion of the employee's average earnings below the social security integration level and a second, higher percentage factor is applied to average earnings above the integration level. For example, a plan's benefit formula might provide 1 percent of average earnings up to the social security wage base amount and 1.5 percent of average earnings above the social security wage base amount for each year of service.

Most private sector pension plans included in the surveys were integrated with social security. The BLS data showed that 64 percent of the employees it surveyed were covered by integrated plans. Other studies of private sector plans showed higher percentages of integrated plans ranging from 86 percent to 96 percent.

The data also showed that the offset method was more prevalent than the step-rate method of integrating private sector plan benefits with social security. In the BLS survey, 50 percent of all participants (nearly 80 percent of the participants in integrated plans) were in plans using the offset method.

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The other studies also showed that the offset method is used by private sector plans far more frequently than the step-rate method.

State government plans are generally not integrated with social security. Employees in 43 states are covered by social security. In 37 of these states, the pension plan benefits were paid without regard to social security benefits, 4 states used a step-rate approach, and 2 states used the offset method.

INTEGRATION WITH SOCIAL SECURITY

	BLS	Bankers Trust	Hay	Wyatt	Hewitt	State
	(percentages)					
Integrated	64	86	91	96	93	14
Offset method	(50)	(56)	(65)	(66)	(70)	(5)
Step-rate	(14)	(30)	(26)	(30)	(23)	(9)
Not integrated	36	14	9	4	7	86

BASES FOR COMPUTING BENEFITS IN COMPENSATION-BASED PLANS

Data on compensation-based plans showed that an employee's final average salary[3] is the most common basis for computing benefits. In the BLS survey, the benefits for 74 percent of participants in compensation-based plans were based on their final average salary. Benefits for about one-fourth of the participants in the BLS survey were based on career average salary. The other studies showed that a final average salary was used in computing benefits in 76 percent to 98 percent of the private sector plans surveyed. Similarly, nearly all (98 percent) of the state government plans used a final average salary.

The BLS survey showed that 64 percent of the participants in compensation-based plans were in plans using a 5-year average salary. Other studies of private sector plans showed use of the 5-year salary average ranging from 45 percent to 76 percent. The 45-percent figure came from the Wyatt Company's survey of the top 50 Fortune industrial companies. Many of the companies in this survey are in the oil and chemical industries where a 3-year salary average is typically used.

In state government plans, a slight majority (52 percent) of the plans used a 3-year final average salary as the basis for computing benefits.

[3]The final average salary is that salary earned over the last several years of employment (e.g., 3 to 5 years) and averaged to compute an annual salary.

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BASES FOR COMPUTING BENEFITS IN COMPENSATION-BASED PLANS

	BLS	Bankers Trust	Hay	Wyatt	Hewitt	State
	(percentages)					
Final average salary	74	76	85	98	89	98
3-year average	(7)	(12)	(14)	(49)	(10)	(52)
5-year average	(64)	(63)	(68)	(45)	(76)	(36)
Other	(3)	(1)	(3)	(4)	(3)	(10)
Career average	22	20	9	-	11	2
Other	4	4	6	2	-	-

Furthermore, analysis of the BLS compensation-based plans showed that about 46 percent of the participants were in plans which included more than the employees' basic pay in the compensation base. Other types of compensation included were overtime, shift differentials, bonuses, and commissions.

BENEFIT FORMULAS

Benefit formulas varied considerably with no single formula being a prevailing practice. The social security offset benefit formulas were applied to the largest group of participants in compensation-based plans. The BLS survey showed that the most common benefit accrual rates for participants in these plans were between 1.5 percent and 1.74 percent of final average salary, multiplied by years of service, and offset by 1.5 percent to 1.67 percent of social security benefits for each year of service. The Hay Associates survey found the same accrual rates to be the most common in the offset plans it studied.[4]

EMPLOYEE CONTRIBUTION REQUIREMENTS

All studies showed that few private sector employers require employees to contribute toward the cost of their pension plan benefits. However, most state government pension plans require employee contributions. The BLS data showed that 93 percent of the employees were covered by plans that did not require employee contributions. The other studies also showed that the majority (78 percent to 91 percent) of private sector plans were fully paid for by the employer. On the other hand, 47 states (94 percent of the state plans) required employee contributions.

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[4]As a separate effort, we are determining the benefit amounts that selected nonfederal pension plans would provide to employees at various salary levels, ages, and years of service. A report on this effort will be issued later.

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EMPLOYEE CONTRIBUTION REQUIREMENTS

	BLS	Bankers Trust	Hay	Wyatt	Hewitt	State
	(percentages)					
Contributions required	7	9	11	22	9	94
Contributions not required	93	91	89	78	91	6

Of the 47 state pension plans that require employee contributions, 38 plans require all employees to contribute the same percentage of their pay regardless of pay levels. Thirty-one of the 38 states also provide social security coverage. As shown below, 27 of the 31 plans with social security require employees to contribute 6 percent or less of their pay to the plan. The seven plans without social security require employee contributions of 4.25 percent to 8.5 percent of pay.

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STATE RETIREMENT PLANS REQUIRING UNIFORM EMPLOYEE CONTRIBUTIONS

Contribution percentage	Number of plans
Plans with social security	
2.0	1
3.0	2
4.0	5
4.5	1
5.0	7
5.01	1
5.11	1
5.57	1
6.0	8
7.0	1
7.85	1
8.95	1
Varies by age at enrollment	1
Subtotal	31
Plans without social security	
4.25	1
6.5	1
7.0	2
8.0	2
8.5	1
Subtotal	7
Total	38

The other nine state contributory pension plans have variable employee contribution rates, whereby one rate applies below a certain salary level and another rate applies above the specified level. All nine states also provide social security. The contribution requirements in these states are summarized below.

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STATE RETIREMENT PLANS WITH VARIABLE EMPLOYEE CONTRIBUTION RATES

Contribution percentage		
Below specified salary amount	Above specified salary amount	Number of plans
0	5.0	2
2.0	5.0	1
3.0[a]	5.0	2
3.6	4.8	1
3.7	0.0	1
4.0	6.0	1
4.6	9.2	1
Total plans		9

[a]One of these plans requires employee contributions only on salaries over $6,000.

A possible trend in state and local government pension plans is the use of employer "pick up" of employee contributions as authorized by section 414(h)(2) of the Internal Revenue Code. A "pick up" plan permits employees to exclude from current personal taxable income any contributions they make to the pension plan and thereby defer taxation on the contribution amounts until retirement benefits are received. For tax purposes, the contributions are considered to be made by the governmental employer.

According to information published by the Wyatt Company in January 1983, 5 states had statutory authorization to implement, or had implemented, 414(h)(2) plans on a statewide basis; 8 states had authorization to implement, or had implemented, such plans on a local option basis; and another 16 state/local systems were studying the possibility of implementing a 414(h)(2) arrangement.

For example, the state that requires its employees to contribute 8.95 percent of pay (the highest rate in all the states) to its pension plan has a 414(h)(2) plan. The employees' ability to defer taxation on the contributions results in a much lower effective contribution rate.

MINIMUM REQUIREMENTS FOR UNREDUCED ANNUITY

The majority of employees in private sector plans included in the surveys could receive unreduced pension benefits by age 62. In the states, unreduced benefits were typically payable by age 60.

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AGE FOR UNREDUCED ANNUITY

	Any age	Age 55	Age 60	Age 62	Age 63-65
	(percentages)				
BLS	13	11	11	21	44
Bankers Trust*	9	11	14	37	28
Hewitt	2	9	14	36	39
Hay	5	6	11	29	49
Wyatt	0	18	38	38	6
State	32	12	32	6	18

*Does not add due to rounding and includes both compensation-based and dollar amount plans

The studies also showed that service requirements were greater when full annuities were available at younger ages. Plans providing unreduced annuities at any age or age 55 generally required 30 years of service. At age 62, plans usually required 10 or fewer years of service.

EARLY RETIREMENT

As a general rule, private sector and state pension plans permit employees to retire before they attain the age and service requirements necessary for the payment of unreduced benefits. As shown below, early retirement is typically available by age 55.

AGE FOR EARLY RETIREMENT

	Any age	Less than age 55	Age 55	Age 60	Age 62
	(percentages)				
BLS*	7	6	82	4	1
Bankers Trust**	15	7	72	6	0
Hewitt	6	7	83	4	0
Hay	13	6	75	6	0
Wyatt	24	6	60	10	0
State	44	8	42	6	0

*Compensation-based plans only
**Includes both compensation-based and dollar amount plans

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Private sector and state pension plans require that benefit amounts be reduced when employees retire early.[5] As the following chart shows, BLS, Hay Associates, the Wyatt Company, and state pension plan studies all indicated that percentage reductions, not necessarily based on precise actuarial factors, are most often used in calculating early retirement benefits. Actuarial reductions, based on individual retirees' ages and life expectancies, were used in a few plans.

REDUCTION FACTORS FOR EARLY RETIREMENT BENEFITS

	BLS			Hay*	Wyatt	State
	All formulas	Dollar amount formulas	Compensation-based formulas*	(percentage of plans)		
	(percentage of participants)					
Actuarial	21	23	19	31	6	24
Percentage						
Uniform	46	57	40	25	49	55
Varies by service	3	-	5	-	11	-
Varies by age	30	20	35	45	34	21

*Totals do not add due to rounding

SUPPLEMENTAL EARLY RETIREMENT BENEFITS

In some plans, early retirees receive supplemental benefits. The most common benefit supplement was to delay any offset for social security until social security was payable. The BLS data showed that 3 percent of participants were eligible for this supplement, and, according to other studies containing such data, a range of from 6 percent to 28 percent of the plans delayed the social security offset. The BLS data also showed that 10 percent of the participants were eligible for additional benefits, such as flat dollar amounts or an amount multiplied by years of service with the company, and other studies showed 3 percent and 26 percent of the surveyed plans had additional benefits.

[5]The effect of early retirement reductions on benefit levels will be more fully explored in our separate analysis of benefits paid by nonfederal plans. (See p. 7.)

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SUPPLEMENTAL EARLY RETIREMENT BENEFITS

	BLS			Bankers Trust	Hay	Wyatt
	All formulas	Dollar amount formulas	Compensation-based formulas	(percentage of plans)		
	(percentage of participants)					
Social security offset delayed	3	1	4	28	6	22
Additional benefits paid	10	21	5	N/A	3	26

BENEFITS FOR SERVICE AFTER AGE 65

The BLS data showed that 58 percent of employees in dollar amount plans received credit for service after age 65, whereas only 35 percent of employees covered by compensation-based plans received such credit. Studies by Hewitt Associates and Hay Associates showed that most plans surveyed did not credit service after age 65. The Wyatt Company's study, on the other hand, indicated that 62 percent of the top 50 companies' plans granted such credit. Also, 76 percent of the states had no limitation on service credits. In the states that had a limitation, it related to the maximum annual benefit the plan would pay to any retiree regardless of age.

BENEFIT CREDITS FOR PRIVATE SECTOR SERVICE AFTER AGE 65

	BLS			Hay	Wyatt	Hewitt
	All formulas	Dollar amount formulas	Compensation-based formulas			
	(percentages)					
Service credited	42	58	35	26	62	38
No service credited	58	42	65	74	38	62

DISABILITY PROVISIONS

According to the studies and data bases, private sector and state employers generally provide disability benefits to employees who are unable to perform their jobs because of physical or mental impairments. The studies showed that, in the private sector, disability benefits may come from the pension plan, a long-term disability (LTD) insurance plan, or both. According to the BLS study, separate LTD insurance plans are used most often to cover employees who participate in compensation-based pension plans. The Hay Associates and Hewitt Associates studies which concentrated on compensation-based plans also indicated this

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practice. Only five states had LTD insurance plans. The other states provided for disability payments from the retirement plan.

When disability coverage is part of the pension plan, benefits may be payable immediately or deferred until the disabled employee reaches the plan's regular retirement age. The BLS data showed that, overall, most employees were in plans with immediate disability pension benefits. In most cases, these benefits were calculated under the regular pension formula and were not subject to early retirement reductions. Similarly, the majority (96 percent) of the states provided immediate disability pension benefits, and 80 percent provided unreduced benefits.

However, BLS also found that the deferred payment approach was most often used when employees were also covered by LTD insurance plans. Similarly, the Hewitt Associates study showed that about 76 percent of the pension plans it surveyed provided deferred disability pension benefits. Both BLS and Hewitt Associates showed that service credits were usually granted during the deferral period.

The data on private sector disability coverage are summarized below.

DISABILITY BENEFIT COVERAGE

BLS

	All formulas*	Dollar amount formulas	Compensation-based formulas
	(percentage of participants)		
Covered by LTD insurance	47.2	23.0	59.1
Immediate pension plan benefits	(16.2)	(19.5)	(14.6)
Deferred pension plan benefits	(26.2)	(3.2)	(37.5)
No disability benefits in pension plan	(4.8)	(.3)	(7.0)
Not covered by LTD insurance	52.7	77.0	40.9
Immediate pension plan benefits	(42.6)	(69.7)	(29.4)
Deferred pension plan benefits	(4.3)	(1.6)	(5.7)
No disability benefits in pension plan	(5.8)	(5.7)	(5.8)

	Hewitt		Hay	
	Number	Percent	Number	Percent
Companies surveyed	710	100	853	100
Companies with LTD insurance	677	95	791	93
Companies without LTD insurance	33	5	62	7

*Total does not add due to rounding

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DISABILITY RETIREMENT BENEFIT PROVISIONS

BLS

	All formulas	Dollar amount formulas	Compensation-based formulas*
	(percentage of participants)		
Immediate disability retirement benefits			
Total	65.9	94.9	50.4
Unreduced regular formula	(50.7)	(79.2)	(35.6)
Reduced regular formula	(8.3)	(8.3)	(8.2)
Other than regular formula	(6.9)	(7.4)	(6.6)
Deferred disability retirement benefits			
Total	34.1	5.1	49.5
Service at time of disability only	(3.7)	(1.0)	(5.1)
Service at time of disability with some additional service credit	(1.0)	(.3)	(1.4)
Service credited to early retirement eligibility or later	(29.4)	(3.8)	(43.0)

Hewitt

	Percent of plans
Immediate disability retirement benefits	
Total	23.5
Unreduced regular formula	(20.4)
Reduced regular formula	(3.1)
Deferred disability retirement benefits	
Total	76.5
Service at time of disability only	(18.5)
Service credited to early retirement eligibility or later	(58.0)

*Total does not add due to rounding

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According to the BLS data, more than 50 percent of the employees had to have at least 10 years of service to be eligible for disability benefits under the pension plans.

ELIGIBILITY REQUIREMENTS FOR DISABILITY RETIREMENT BENEFITS

BLS

	All formulas*	Dollar amount formulas	Compensation-based formulas*
	(percentages)		
Total	100.0	100.0	100.0
No age or service requirement	15.9	2.6	23.0
Age requirement only	.4	.0	.6
5-9 years service	3.2	4.0	2.8
10-14 years service	32.1	60.3	17.2
15-19 years service	17.5	19.1	16.7
20-24 years service	1.3	2.8	.5
25-29 years service	.2	.2	.2
Other	1.5	.2	2.2
Age and service	7.1	8.8	6.3
Sum age plus service	.7	.0	1.0
Meet LTD insurance requirements	20.0	2.0	29.6

*Totals do not add due to rounding

On the other hand, 38 percent of the states required 5 years' service to be eligible for disability benefits, and an additional 36 percent had a 10-year service requirement.

LTD INSURANCE PLANS

LTD plans are usually contracts with insurance carriers to provide disability benefits for employees. According to BLS, when an employer has an LTD insurance plan, it is the practice for insurance benefits to become available when short-term disability benefits have expired. LTD insurance benefits are paid as long as the disability continues or until such time as the individual reaches retirement age. At that time, retirement benefits are paid, and insurance payments are terminated.

The BLS data showed that 78 percent of the participants covered by LTD insurance plans did not contribute to the plans. Hay Associates and Hewitt Associates data showed that 75 percent and 53 percent, respectively, of the companies surveyed did not require employee contributions for LTD insurance.

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EMPLOYEE CONTRIBUTIONS FOR LTD INSURANCE

	BLS	Hay	Hewitt
	—(percentages)—		
Employee contributions required	22	25	47
Employee contributions not required	78	75	53

According to BLS, 61 percent of the participants would receive 60 percent or more of their annual pay from the insurance plan, and another 37 percent would receive at least 50 percent. These are consistent with Hay Associates and Hewitt Associates data showing that 79 percent and 67 percent of the LTD insurance plans provided 60 percent or more of pay. An additional 19 percent and 16 percent of the plans in the Hay Associates and Hewitt Associates surveys provided at least 50 percent.

LTD INSURANCE INCOME AS A PERCENT OF ANNUAL PAY

Percent	BLS	Hay	Hewitt
	—(percentages)—		
Less than 50	2	2	1
50-59	37	19	16
60	46	60	52
65-69	10	17	11
70 or more	5	2	4
Based on years of service	-	-	16

The BLS found the majority of participants would have their LTD insurance benefits reduced when other benefit payments were received. The reductions were for such items as worker's compensation, social security benefits, railroad retirement payments, state disability benefits, and company-sponsored pension benefits.

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OFFSETS TO LTD INSURANCE PAYMENTS

BLS

Offsets	Percent of participants
Worker's compensation	
Deduction made	90
No deduction	10
Social security benefit	
Deduction made	88
No deduction	12
Railroad retirement	
Deduction made	90
No deduction	10
State disability benefits	
Deduction made	84
No deduction	16
Employer's pension benefits	
Deduction made	67
No deduction	33

SURVIVOR BENEFITS

The various surveys we reviewed had limited data on pension plan survivor benefits. The most complete information was in the BLS data base.

The BLS data showed that almost 60 percent of the employees had to be eligible for early retirement before survivor benefit coverage was provided by their plans.

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ELIGIBILITY REQUIREMENTS FOR
PRE-RETIREMENT SURVIVOR BENEFITS

BLS

	All formulas*	Dollar amount formulas	Compensation-based formulas*
	(percentages)		
Total	100.0	100.0	100.0
No age or service required	1.3	.4	1.7
Age requirement only	3.6	1.8	4.5
5-9 years service	.4	-	.6
10-14 years service	5.2	4.2	5.6
15-19 years service	7.1	11.7	4.8
20-24 years service	.7	-	1.0
25-29 years service	1.6	.5	2.1
30 or more years service	4.8	13.8	.3
Age and service	12.2	9.8	13.3
Sum of age and service	2.1	1.2	2.6
Eligibility for normal retirement	1.5	.6	2.0
Eligibility for early retirement	59.7	55.9	61.5

*Totals do not add due to rounding

However, there was no prevailing practice found on eligibility requirements for pre-retirement survivor benefits in state plans. The requirements range from immediate eligibility for benefits to requiring that individuals be eligible for early retirement before such benefits are available.

The studies showed that a wide range of choices was made available to the private sector retirees with respect to the form in which a survivor benefit may be elected. As shown below, the prevailing practice was to reduce the retiree's benefit actuarially so there was no additional cost to the pension plan when a retiree elected survivor benefits. Comparable data on state pension plans were not available.

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SURVIVOR BENEFIT REDUCTIONS

	BLS			Hay
	All formulas	Dollar amount formulas	Compensation-based formulas	(percent of plans)
	(percent of participants)			
Benefit reduced actuarially	76	62	83	89
Benefit reduced less than actuarially	19	35	10	2
No reduction	5	3	7	9

POST-RETIREMENT BENEFIT ADJUSTMENTS

Social security benefits paid to nonfederal sector retirees are fully indexed for inflation. The studies showed that many private sector and state pension plans also adjusted benefit amounts after retirement.

In private sector plans, adjustments are usually granted on an ad hoc basis. The BLS data showed that 40 percent of the surveyed participants were in plans that had granted at least one adjustment during 1978 to 1981, and 93 percent of them were made on an ad hoc basis. The other private sector studies showed that from 57 percent to 78 percent of the plans they covered had granted adjustments in about the same time period.

PRIVATE SECTOR POST-RETIREMENT ADJUSTMENTS

	BLS 1978-81	Bankers Trust 1975-80	Hay 1976-82	Wyatt 1980-82	Hewitt 1978-82
	(percentage of total)				
At least one adjustment given	40	72	57	78	66
No adjustment given	60	28	43	22	34

A broad-based study by North Carolina State University for the Department of Labor supported the above data. This study, entitled "Inflation and Benefits, A Study of COLA Adjustments and Pensions in the Private Sector," examined pension payments during 1973 to 1979 to a statistical sample of all private sector retirees who were retired in 1972. The study found that 75 percent of the retirees had received adjustments during the 1973-79 time period, with one-third to one-half of all retirees receiving adjustments in any given year. About 25 percent had received adjustments every year.

The Labor study showed that the magnitude of post-retirement adjustments varied substantially by plan size, with larger plans granting the greatest

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increases. As shown below, the average increase during the time period for all retirees, including those who received no adjustments, was 24 percent. The increases ranged from 3.5 percent for retirees in the smallest plans to 36.2 percent for retirees in the largest plans. As a percentage of the increase in the CPI during the period, the adjustments averaged 37.9 percent, ranging from 5.5 percent for the smallest plans to 57.2 percent for the largest plans.

AVERAGE BENEFIT INCREASES BY PLAN SIZE
1973-1979

Number of plan recipients	Average percentage increase	Average increase as percentage of CPI increase
1-99	3.5	5.5
100-499	14.9	23.5
500-999	13.8	21.8
1,000-4,999	9.6	15.2
5,000-9,999	21.0	33.2
10,000 and over	36.2	57.2
Overall average	24.0	37.9

Thirty (60 percent) state pension plans provided for automatic adjustments based on increases in the CPI. Such automatic increases were generally limited to 3 percent of pension amounts each year. In 18 states (36 percent), adjustments were granted on an ad hoc basis, and 2 states (4 percent) did not adjust benefits.

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CHAPTER 3

CAPITAL ACCUMULATION PLANS

In addition to social security and pension plans, many nonfederal employers provide capital accumulation plans as a third component of their employees' retirement income packages. Some employers sponsor more than one type of plan. This chapter focuses on the capital accumulation plans we found to be the most prevalent in the nonfederal sector--savings and investment plans (more commonly known as thrift plans) and deferred compensation plans.

Data we reviewed on capital accumulation plans primarily concerned private sector practices. Little information was available on such plans in state and local governments. However, we did note that a November 1982 survey by the Council of State Governments showed that all but 3 of the 36 states surveyed had established or authorized deferred compensation plans for their employees in addition to their pension plans.

PREVALENCE OF CAPITAL ACCUMULATION PLANS IN THE PRIVATE SECTOR

With the exception of the Bankers Trust Company, which made a separate analysis of thrift plans only, all the studies of private sector retirement programs covered a range of capital accumulation plans. As shown below, these studies indicated that the majority of the companies surveyed provided capital accumulation plans as part of the retirement income package. The BLS data shows that 74 percent of the establishments it surveyed had capital accumulation plans. The percentages of companies with capital accumulation plans in the Hay Associates, Hewitt Associates, and the Wyatt Company studies were 63 percent, 88 percent, and 98 percent, respectively.

AVAILABILITY OF CAPITAL ACCUMULATION PLANS

	BLS	Hay	Hewitt	Wyatt
Number of companies surveyed	1,287	849	710	50
Number of companies with plans	958	533	623	49
Percent of companies with plans	74	63	88	98
Percent of surveyed companies with both defined benefit pension plans and capital accumulation plans	64	56	83	98

The studies and data showed the following breakdown by type of capital accumulation plan in the companies surveyed.

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TYPE OF CAPITAL ACCUMULATION PLANS PROVIDED

	BLS	Hay	Hewitt	Wyatt
Thrift plan	193	367	215	14
Thrift and stock-ownership plans	199	[a]	202	26
Thrift and profit-sharing plans	80	—	42	--
Profit-sharing plan	223	166	70	2
Profit-sharing and stock-ownership plan	86	[a]	52	5
Stock-ownership plan	177	[a]	42	2
Total	958	533	623	49

[a]160 companies had stock-ownership plans, but data was not available to determine whether any or all plans were in addition to thrift or profit-sharing plans.

THRIFT PLANS

Thrift plans are a type of capital accumulation plan wherein employers help employees save for retirement and other needs by matching some portion of the employees' contributions to the plan. (In a few cases, employers contribute to employee thrift accounts without requiring any employee contributions.) Employer contributions and investment income are not taxable to the employee until funds are withdrawn.

The studies showed that employer-matching percentages were usually at fixed rates which ranged from 10 percent to over 100 percent of employee contributions. However, the amount of employee contributions subject to employer matching was generally limited to a specified percentage of pay. As shown in the following tables, most employers matched at least 50 percent of employee contributions up to a specified level. Employee contributions of at least 6 percent of pay were subject to employer matching in most plans.

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PERCENTAGE OF EMPLOYEE CONTRIBUTIONS MATCHED BY EMPLOYER

Employer-matching percentage	Hewitt	Hay	Bankers Trust	Wyatt
	—(percentage of companies)—			
10-20	2	2	6	-
25	9	6	11	-
30-45	4	4	9	2
50	41	41	46	29
55-95	6	7	4	13
100	15	15	14	31
Over 100	2	1	2	2
Varies by profit	10	13	-	5
Varies by amount of employee contribution	3	-	-	2
Varies by years of participation or service	8	10	-	8
Other	-	1	8	8
Total	100	100	100	100

MAXIMUM EMPLOYEE CONTRIBUTION USED IN EMPLOYER-MATCHING FORMULA

Employee contribution (percent of pay)	Hewitt	Hay	Bankers Trust	Wyatt
	——(percent of companies)—			
2	3	3	3	2
3	5	7	4	2
4	8	10	9	-
5	17	16	19	10
6	56	54	44	39
Over 6	10	10	16	18
Other (flat dollar amount)	1	-	5	29
Total	100	100	100	100

The Hay Associates and Hewitt Associates studies also showed that most plans surveyed allowed employees to contribute amounts above the employer-matching level. In most cases, unmatched employee contributions of 6 percent of pay or more were allowed.

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EMPLOYEE CONTRIBUTIONS ABOVE THE EMPLOYER-MATCHING LEVEL

Percent of compensation	Hewitt (percentage of companies)	Hay (percentage of companies)
2-5	37	41
6-9	23	40
10 or more	40	19
Total	100	100

Thrift plan eligibility requirements

The studies showed that the majority of thrift plans permitted employees to participate in the plan after being employed for 1 year.

THRIFT PLAN SERVICE ELIGIBILITY REQUIREMENTS

	Bankers Trust	Hay*	Wyatt*
	(percentages)		
Immediate coverage	10	11	11
6 months or less	18	13	16
1 year	67	70	71
Over 1 year	5	5	3

*Totals do not add due to rounding

Vesting in employer contributions to thrift plans

The studies showed that most thrift plans provided for employee vesting in employer contributions in 5 years or less.

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THRIFT PLANS
VESTING IN EMPLOYER CONTRIBUTIONS

	Bankers Trust	Hay
	-(percentages)-	
Immediate	11	17
Class year[a]		
Less than 3 years	15	7
3 years	14	6
More than 3 years	12	4
Service/participation[a]		
Less than 5 years	7	15
5 years	25	29
6-9 years	8	7
10 or more years	8	15
Total	100	100

[a]Class year is a form of graduated vesting and service/participation is a form of cliff vesting as defined on page 4.

Employee participation in thrift plans

According to the studies, most eligible employees participated in their employers' thrift plans. The studies showed participation rates of at least 65 percent in the majority of the plans. There was also a relationship between employer-matching percentages and employee participation—the higher the matching percentage, the more employees participated.

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EMPLOYEE PARTICIPATION IN THRIFT PLANS

Percentage of eligible employees participating	Hay (percentage of plans)	Bankers Trust (percentage of plans)
Less than 50	12	17.6
50-64	18	19.5
65-74	23	19.9
75-89	36	30.0
90-100	11	13.0
Total	100	100.0

Employer-matching percentages	Hewitt (percentage of participating eligible employees)	Bankers Trust (percentage of participating eligible employees)
25	63	52
50	65	73
100	74	86
Average	67	70

DEFERRED COMPENSATION PLANS

A recent innovation in the capital accumulation portion of nonfederal retirement programs has been the use of deferred compensation plans authorized by section 401(k) of the Internal Revenue Code. These plans contain many features of thrift plans (the major difference being that employee contributions to 401(k) plans are made with pre-income tax dollars). The Internal Revenue Service issued proposed regulations in November 1981, but final regulations have not yet been issued. However, despite the lack of final regulations, 401(k) plans have grown in popularity and provide tax-sheltered retirement funds for those employees who participate.

Under the 401(k) approach, an employee can elect to defer a portion of his/her salary and have the employer deposit the deferred amount into an investment account. The amount of the salary deferral, any employer contributions to the account, and investment earnings are exempt from personal income taxes until the employee withdraws the funds. Funds from 401(k) plans can be withdrawn upon the employee's retirement, death, disability, separation from service, attainment of age 59-1/2, or demonstration of financial hardship.

There was limited data available on 401(k) plans in the surveys we used in our analysis of nonfederal retirement programs. Consequently, we supplemented them with the following surveys:

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—"Hot Topics in Retirement Plans, A Survey of the Hewitt Compensation Exchange," Hewitt Associates, 1983. A survey of 307 corporations.

—"Salary Reduction Plans: Design Features and Experience, A TPF&C Survey Report, November 1983," Towers, Perrin, Forster, and Crosby, 1983. A survey of 79 companies with 401(k) plans.

—"The Use of 401(k) Plans by Medium Sized Companies, A Meidinger Survey," Meidinger, Inc., 1983. A survey of 256 medium sized companies in 38 states.

According to the data, more than half of the companies surveyed (ranging from 50 percent to 70 percent in the various surveys) had adopted, were in the process of adopting, or were considering adopting a 401(k) plan. More importantly, only 6 percent of the companies in one survey and 12.6 percent in a second survey had definitely decided not to adopt a 401(k) plan.

In all of the surveys, it was the common practice (from 76 percent to 84 percent) for the employer to match part or all of employees' salary deferrals. The data indicated that a 50-percent match was the most prevalent practice. Six percent of pay was the most frequently permitted deferral subject to matching, although a few companies permitted much higher amounts (16 percent and 20 percent in two of the studies). In many instances, companies amended or used an existing thrift plan when establishing a 401(k) plan.

In 401(k) plans, the higher paid third of employees eligible to participate in the plan are not permitted to defer a substantially greater percentage of their salary than the lower paid two-thirds of employees. Hewitt Associates and Towers, Perrin, Forster, and Crosby studies showed that the median deferred percentage was 4.6 percent and 4.89 percent for the higher paid third of employees and 2.8 percent and 3.43 percent for the lower paid two-thirds of employees. According to Hay Associates, deferrals ranged from 1 percent to 10 percent of pay, with most deferrals being 4 percent to 7 percent, and data from Hewitt Associates indicated that the average deferral for all employees was about twice as large when the employer made matching contributions.

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